Supreme Court of the United States

OCTOBER TERM, 1939.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,

vs.

GEORGE B. CLIFFORD, JR.

BRIEF FOR THE RESPONDENT IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

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CITATIONS

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OPINION BELOW

Subsequent to the filing of the petition for a writ of certiorari by the Commissioner, the opinion of the Circuit Court of Appeals (R. 70) has been reported: *Clifford vs. Helvering, Commissioner of Internal Revenue,* 105 F. (2d) 586 (C. C. A. 8th, July 19, 1939).

STATEMENT

The respondent declared himself trustee of certain securities (R. 10). As trustee he held "all the net income from the trust estate," "exclusively for the benefit of Virginia R. Clifford" (R. 11). The trust provided in identical terms for distribution of principal and income on the termination of the trust: "all accrued and undistributed net income from the trust estate * * * in my (respondent's) hands as

trustee shall be deemed and treated as property owned absolutely by Virginia R. Clifford * * *, and the remainder of the trust shall be deemed and treated as property owned absolutely by me" (R. 11). The trust defined capital and income (R. 11). The net income of the trust has been distributed to the beneficiary, Mrs. Clifford (R. 13). The respondent as trustee has paid federal income tax upon capital gains, and Mrs. Clifford has paid tax upon net income of the trust from other sources (R. 15). The respondent personally paid federal gift tax upon the value of the trust to Mrs. Clifford (R. 13).

ARGUMENT

Before argument on specific points, it should be noted that the same issues here involved were recently before three different Circuit Courts of Appeal. Each court reached the same conclusion—the trust income is not taxable to settlor:

Corning vs. Commissioner, 104 F. (2d) 329 (C. C. A. 6th, June 6, 1939).

Commissioner vs. Wood, 104 F. (2d) 1013 (C. C. A. 5th, May 29, 1939).

Clifford vs. Commissioner, 105 F. (2d) 586 (C. C. A. 8th, July 19, 1939).

I.

An Adverse Decision by a Circuit Court of Appeals Relating to an Unambiguous Statute Is Not Ground for Certiorari.

The court below did not even consider any claimed unconstitutionality of the statute. The court held, very simply, that an unambiguous statute taxing the income from a revocable trust to the settlor is not applicable to an irrevocable trust.

Section 166 of the *Revenue Act of 1934* (c. 277, 48 Stat. 680) applies only to a revocable trust.[1] The present trust continues for five years or until the earlier death of the settlor or beneficiary (R. 11).[2] There is no power of revocation vested in anyone. The only right vested in the settlor is a reversion at the end of the trust.

A reversionary interest is not a power of revocation. The decision below which recognizes this manifest distinction is not the proper object of certiorari.

The distinction is clear in legal terminology. *Bouvier's Law Dictionary* (3rd Rev.), pp. 2646-2647, defines a power of revocation as "The right, ability, or faculty". * * * "to divest, or abridge an existing estate." *Bouvier's Law Dictionary* (3rd Rev.), p. 2954, defines a reversion as: "*Reversion.* The residue of an estate left in the grantor, to commence in possession after the determination of some particular estate granted out by him."

The Circuit Courts of Appeal have unanimously applied the distinction in federal income tax cases. They have unanimously held that a grantor of a trust for the benefit of an-

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[1]SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor. (U. S. C., Title 26, Sec. 166.)

[2]The trust hereby created shall continue for a term of five (5) years from the date of this Declaration of Trust unless the life beneficiary or myself shall die during said term, and at the expiration of said term or upon the earlier death of the life beneficiary or myself during said term, whichever event shall first occur, the trust hereby created shall forthwith and without any further act or deed terminate.

other for a definite period is not taxable on the income of the trust:

United States vs. First National Bank of Birmingham, 74 F. (2d) 360 (C. C. A., 5th, 1934).

Commissioner vs. Wood, supra.

Clifford vs. Helvering, supra.

The decisions of the Board of Tax Appeals are also uniform and are to the same effect:

Wood vs. Commissioner, 37 B. T. A. 1065 (1938).

Hormel vs. Commissioner, 39 B. T. A. 244 (1939).

Achelis vs. Commissioner, B. T. A. Docket Nos. 89, 435 and 92, 359, Memorandum Opinion, August 31, 1938.

Chamberlain vs. Commissioner, B. T. A. Docket No. 89, 926, Memorandum Opinion, March 14, 1938.

The Commissioner concedes there is no conflict in the decisions.

The Commissioner apparently does not claim that the income of the present trust is taxable to the respondent under Section 166 except by virtue of legislative history and Treasury Regulations.

It is suggested that the amendment of Section 166 in the *Revenue Act of 1934* (c. 277, 48 Stat. 680), by eliminating the words "during the taxable" and "for such taxable year" had the effect of taxing income of this trust to the respondent. In the generally accepted use of words, however, the section still applies only to revocable trusts. The apparent intention of Congress was to tax revocable trusts in which the power to revoke could be exercised only upon giving notice in the preceding taxable year. The Commissioner suggests collateral records of Congressional proceedings show an intention to cover irrevocable trusts. He neglects, however, to mention that the Treasury Department requested an

amendment covering term trusts as well as revocable trusts and that Congress refused any amendment as to term trusts.

The request of the Treasury Department is contained in *Treasury Department's New Law Recommendations—Statement of the Acting Secretary of the Treasury Regarding the Preliminary Report of a Subcommittee of the Committee on Ways and Means—Additional Recommendations* (C. C. H., Standard Federal Tax Service, 1934, Vol. III, p. 6707):

> "(6) The income from short-term trusts and trusts which are revocable by the creator at the expiration of a short period after notice by him should be made taxable to the creator of the trust."

The *Revenue Bill of 1934* as introduced in and passed by the House of Representatives did not amend Section 166 of the *Revenue Act of 1932* (Ch. 209, 47 Stat. 169). The Senate did amend Section 166 as to revocable trusts. The conference committee of the two Houses adopted the Senate provision. Report of Conference Committee (73rd Cong., 2d Sess., H. Rept. 1385, p. 24). The Treasury Department had asked Congress for two amendments, one as to term trust, the other as to revocable trusts. Congress gave the Treasury Department one amendment only—that concerning revocable trusts. The Treasury now asks this court for the other amendment refused by Congress.

Departmental Regulations, even if consistent, cannot enlarge the clear language of a statute carrying out Congressional intention. *United States vs. Missouri Pacific Railroad Co.*, 278 U. S. 269. Here, moreover, there has been no uniformity in departmental construction. The original regulation under Section 166 as amended in the *Revenue Act of 1934* was Regulation 86, Article 166-1. This was subsequently amended by T. D. 4629, C. B. XV-1, 140, 141 (1936) and thereafter by T. D. 4759, C. B. 1937-2, 117, 118. The

change and conflict in ruling are readily apparent from a comparison of the present version (printed in the appendix to petitioner's brief, p. 12) and the original regulations (printed in appendix hereto). The original regulation sought to tax the grantor on the income from any trust in which he retained any interest. This position had at least some basis in logic, but it has been abandoned by the Treasury Department in its acquiescence to *Downs vs. Commissioner,* 36 B. T. A. 1129 (1937), C. B. 1938-1, p. 9. In fact, the invalidity of the entire reasoning has been admitted in I. T. 3238, C. B. 1938-2, 204, at p. 205:

> "In view of the above decision of the Board of Tax Appeals, in which the Bureau has acquiesced, it is held that inasmuch as the entire income of the trust is distributable to the beneficiary and the possible future revesting of the corpus of the trust in the grantor is governed entirely by the terms of the trust instrument itself and is in no way dependent upon the exercise of any power vested in the grantor or any person not having a substantial adverse interest therein, the income of the trust is not taxable to the grantor."

This statement of the Treasury Department is, literally, just as applicable to the case at bar as it was to the Downs case, *supra.* There was certainly no uniformity of construction justifying the Congressional adoption of the current departmental regulation. *Iselin vs. United States,* 270 U. S. 245.

Finally, the precise point has been regarded as settled by this court:

Blair vs. Commissioner, 300 U. S. 5.

Douglas vs. Willcuts, 296 U. S. 1.

There is no new important point of law raised by the first suggestion of the Commissioner.

If there is any confusion in the administration of the tax

laws, it is of the Department's own making. It is not shared by the Board of Tax Appeals or by the Circuit Courts of Appeal.

II.

The Decision in This Case Is Not in Conflict With Prior Decisions Dealing With Assignment of Future Income.

The alleged conflict in decisions does not exist. The decisions referred to by petitioner deal with assignment of income. The present decision deals with a transfer of property in trust. In the decisions referred to by the petitioner, the assignor, not the assignee, is liable for tax on income. In the present case, the beneficiary, not the grantor, is liable for the tax.

The exact distinction was carefully considered by the court below, and several cases cited by petitioner in his brief at page 9 were referred to by the court at 105 F. (2d) 590:

> "The rule announced in *Lucas vs. Earl,* 281 U. S. 111, 50 S. Ct. 241, 74 L. Ed. 731, and *Burnet vs. Leininger,* 285 U. S. 136, 52 S. Ct. 345, 76 L. Ed. 665, to the effect that the actual earner or recipient of income cannot by assignment avoid the statutory liability is not pertinent, because as owner of the beneficial interest, the beneficiary here is entitled to the income therefrom and is in turn taxed on that income by the statute."

Where there has been an assignment of income as distinguished from a transfer of property, the Circuit Court of Appeals for the Eighth Circuit has followed and applied the decisions of this court that the assignor of future income from earnings or from property owned by him remains liable for tax on such income.

Van Meter vs. Commissioner, 61 F. (2d) 817 (C. C. A. 8th).

The petitioner suggests more particularly that there is conflict between the decision of the Circuit Court of Appeals for the Sixth Circuit in *Bulkwill vs. Commissioner*, 77 F. (2d) 569 (C. C. A. 6th, 1935), and the decision in the present case. There is patently no conflict. In the *Bulkwill* case the taxpayer declared himself trustee of his interest in a partnership without substituting himself as trustee as a partner; the case therefore follows *Burnet vs. Leininger*, 285 U. S. 136. There is absolute harmony in the decisions of these two Circuits. In the only other case where the same argument was applied to a similar set of facts, the United States Circuit Court of Appeals for the Sixth Circuit reached the same result. *Corning vs. Commissioner*, 104 F. (2d) 329 (C. C. A. 6th, June 6, 1939). The court said at page 333:

> "There is no ground for support of the Board's determination that the present trusts are not taxable entities or that the instruments amount to no more than an assignment of income. Discretionary powers were vested with the trustee. It is not to be assumed that such powers would not be exercised, or that connivance between the trustee and the grantor would defeat the express purpose of the grants."

The indirect suggestion that this trust should be inoperative for tax purposes because respondent is the trustee is contrary to a decision of this court. *Becker vs. St. Louis Union Trust Co.*, 296 U. S. 48 (1935).

CONCLUSION

It is therefore respectfully submitted that the petition herein for a writ of certiorari should not be granted.

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APPENDIX

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 166-1. Trusts in the corpus of which the grantor retains an interest.—(a) *Scope.*—Section 166 prescribes that the income, or any part of the income, of certain trusts shall be taxed, not to the trustee nor to the beneficiaries, but to the grantor because of the fact that the grantor has retained a certain interest in the property of the trust. This article deals with the taxation of such income. The term "corpus," as used in this article, means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(b) *Test of taxability to the grantor.*—The sufficiency of the grantor's retained interest in the corpus resulting in the taxation of its income to the grantor is determined by a single test, namely, whether the grantor has failed to divest himself, permanently and definitively, of every right which might by any possibility enable him once more to possess and enjoy in title the trust corpus. For the purposes of this article the sufficiency of the grantor's retained interest in the corpus is not affected by the fact that the grantor has provided that the right to cause the title to the corpus to revest in himself is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the corpus or income therefrom adverse to the grantor.

If the grantor has retained any such interest in the corpus he is taxable on the income therefrom regardless of—

(1) how great or how small, how remote or how contingent the interest may be;

(2) whatever the nature of interest retained may be; whether the interest retained is vested, con-

tingent, in reversion or otherwise; whether conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event; whether taken by appointment, or by designation in the trust instrument, or merely by virtue of the grantor not conveying his whole estate in the corpus, or otherwise;

(3) the time or times at which such interest will revest the title in the grantor in possession and enjoyment, whether within or without the taxable year, whether or not the time be fixed, determinable or certain to come;

(4) whether, if the revesting in the grantor of title to the corpus is in any way dependent upon the act of anyone, that person be the grantor, or any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

For example, a grantor has not permanently or definitively divested himself of title to the corpus if he has placed it in trust for his son, John,

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not being a beneficiary, but being empowered to appoint to anyone other than herself); or

(C) for the term of the grantor's life, then to be

distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor has provided that the title shall or may once more revest in himself by the retention of an interest (executory or otherwise) capable of vesting title in the grantor in possession and enjoyment, in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

Thus the inclusion within the scope of section 166 of any trust is based on the fact that the grantor has retained an interest in the corpus which once more will, or may possibly, vest the title in him in possession and enjoyment. Section 166 makes no distinction between a "revocable trust" (so called because of a provision in the trust instrument permitting some person at some time or in some manner to terminate the trust) and an "irrevocable trust" as such. Some "revocable trusts" are within the scope of section 166, not however by reason of the element of revocability, but because the grantor has reserved the requisite interest in the trust corpus, whether the vesting in title of such interest depends on revocation or otherwise. If no such interest has been retained, a "revocable trust" is not within the scope of section 166, even though the particular trust estate is subject to revocation by the grantor.

If the grantor strips himself permanently and definitively of every such interest in the corpus retained by him, the income of the trust realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161 and 162.

(c) *Income and deductions.*—If, as to any of the corpus, the test of taxability to the grantor is satisfied, the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such corpus as he would have been entitled to had the trust not been created.